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RUEATRS/DEPT OF TREASURY WASHINGTON DC
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C O N F I D E N T I A L SECTION 01 OF 03 SHANGHAI 000784

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STATE PASS FEDERAL RESERVE BOARD FOR
WARSH/AHMED/JOHNSON/SCHINDLER; SAN
FRANCISCO FRB FOR CURRAN/LUNG; NEW YORK FRB FOR DAGES/CLARK
STATE PASS CEA FOR BLOCK
STATE PASS USTR FOR STRATFORD/WINTER/MCCARTIN/LOI/READE
USDOC FOR 4420
USDOC FOR ITA/MAC DAS KASOFF, MELCHER AND MCQUEEN
TREASURY FOR EXEC - TSMITH, OASIA/ISA -DOHNER/BAKER/CUSHMAN
TREASURY FOR AMB HOLMER/MEDEIROS/WRIGHT
TREASURY FOR SOBEL AND MOGHTADER
NSC FOR MCCORMICK AND TONG

E.O. 12958: DECL: X1 MANUAL REVIEW
TAGS: EFIN ECON PGOV CH
SUBJECT: CITI'S STANLEY ON BANKING, ECONOMY, REFORMS, POLITICIANS IN CHINA

REF: A. SHANGHAI 757 AND PREVIOUS

¶B. SHANGHAI 769
¶C. SHANGHAI 777
¶D. GUANGZHOU 1267

CLASSIFIED BY: Christopher Beede, Political/Economic Chief, U.S. Consulate Shanghai, Department of State.
REASON: 1.4 (b), (d)

¶1. (C) Summary: Chinese banks are afraid of Citibank becoming too strong. This has led the Chinese Banking Regulatory Commission (CBRC) to conduct an extraordinarily hostile and intrusive audit of Citi's six-month-old locally incorporated subsidiary. The CBRC's goal appears to be forcing Citi to look and act like a Chinese bank. In terms of financial services, China is not in an opening-up period, according to Citibank (China) CEO Richard Stanley. Stanley told SED Ambassador Holmer that New Politburo Standing Committee Member Xi Jinping is, however, pro-business with an impressive background. Premier Wen Jiabao has a "muddled" decision-making process. In a separate meeting, Stanley told FRB Governor Warsh that he believes inflation is actually higher than the reported 6.5 percent and a worried Central Government will be instituting more draconian cooling-measures in the next year. End summary.

¶2. (SBU) In addition to his November 9 meeting with State Policy Planning Director David Gordon (Ref A), Citibank (China) CEO Richard Stanley met with Strategic Economic Dialogue Special Envoy Ambassador Alan Holmer on November 16 (Ref B) and Federal Reserve System Governor Kevin Warsh on November 19 (Ref C). Embassy Beijing Finatt, Consulate Pol/Econ Chief and Econoff

attended both meetings.

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(C) Chinese Banks Afraid Of Citi Becoming Too Strong
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¶3. (C) Citi's Stanley (strictly protect) told Ambassador Holmer that the then ongoing Chinese Banking Regulatory Commission's (CBRC) audit was motivated more from an attempt to see how Citi works than to see if Citi was doing anything improper. The Chinese regulator "wants to know how Citi works so that the CBRC can control us due to their fear that Citi will become too strong," said Stanley. There is "knowledge transfer" happening as a result of this audit. The CBRC is "deadly serious" about checking Citibank (China)'s independence from Citi International. The CBRC took a "hostile" and "extraordinarily intrusive" approach sending 40 auditors into Citi's Shanghai headquarters for one month.

¶4. (C) Just six months after Citibank incorporated a local subsidiary, the CBRC is trying to make Citi act like a local Chinese bank. This is the opposite of bringing in a successful foreign bank so that the Chinese can learn from them. The Chinese Government is intent on making Citi's branch managers function as Chinese branch managers do. Chinese branch managers, said Stanley, have too much control and independence. (Note: Chinese bank branch members are normally appointed by local Communist Party leadership and are beholden to their local patrons. End note.) A recurring question asked by the auditors is "Why don't you have more Chinese people on your bank board?"

(C) China: More Negative, Less Open

¶5. (C) Stanley told Governor Warsh that the tone of the CBRC

audit is indicative of China's banking sector and its regulator becoming much more nationalistic. China is feeling more and more confident. This confidence is fuelled by the "astronomical" valuations of its banks, such as the Industrial Commercial Bank of China (ICBC), and Chinese officials becoming "strident and arrogant."

¶6. (C) In general, Stanley finds the Chinese Government more inwardly focused than before. He noted that leaders from outside of China and visiting Chief Executive Officers from large companies no longer get the same reception in Beijing that they once received.

¶7. (C) Citing Citi's ongoing problems with the Communist Party-appointed managers at its joint venture (Refs A and D), Stanley said the message he is receiving from Chinese officials is that Chinese banks are not ready to have significant foreign bank participation.

¶8. (C) "We are not in an opening up period" in terms of China's financial sector. Even the tone of China's media is increasingly "quite negative." Stanley noted that he would have expected Chinese media to be positive about the Federal Reserve Bank's approval in November of China Merchants Bank's expansion into the United States. There was, however, "no real praise." "I'm waiting for the second coming of Zhu Rongji," he quipped, hoping that China would return to a more open and receptive environment for foreign financial services, as he implied had been the case under China's Premier from 1998-2003.

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(C) Xi: "Good" -- Wen: "Muddled" -- Shang: "Not Capable"
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¶9. (C) Former Shanghai Party Secretary and recently appointed Politburo Standing Committee Member Xi Jinping is a "very impressive person" with a pro-business background, Stanley said. Xi has a history of being open to foreign investment and from a

commercial standpoint, this is "not a bad outcome."

¶10. (C) Criticizing Premier Wen Jiabao's leadership, Stanley said, "I am looking forward to the day when China has a Premier that can actually make a decision. Wen has a "muddled approach" to decision-making, he added.

¶11. (C) Current Chinese Securities Regulatory Commission (CSRC) Head Shang Fulin is "not capable of running China's financial markets." He has a closed mind and is not open to competition or new ideas.

¶12. (C) China's political calendar affects the Central Government's ability to make decisions concerning China's economy and opening up. "Clearly they have been distracted (in the run-up to the 17th National Party Congress in October) and they continue to be distracted," he opined. "Number one in these people's minds is their next job. They don't get paid a lot. What these officials are working for is power and position."

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(C) Inflation: Higher Than Reported, Draconian Measures Coming
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¶13. (C) The Chinese Government is very worried about inflation. Stanley told Governor Warsh that the 6.5 percent official rate of inflation was a "low-ball number" and that inflation is probably much higher. The Central Government is addressing inflation with a "determination" that Stanley has not previously

seen with regard to overheating. China lacks the fiscal tools and levers to effectively cool down the economy, however. Increasing the banks' required reserve ratio (RRR) is not working, said Stanley. (Note: The People's Bank of China (PBOC) raised the RRR by 100 basis points on December 10, the tenth RRR rise in 2007, bringing total RRR from 9 percent in January to 14.5 percent in December. End note.) The Central Government will continue to resort to the "Chinese methods" of moral suasion and window guidance by continuing to force banks not to lend. More "draconian" measures are coming in the next year, he added.

¶14. (C) The good news, said Stanley, is that all of the plumbing is in place for China to implement a market economy. The Central Government believes, however, that the transition must continue to move slowly. For example, banks in China lack discipline and if the PBOC were to let interest rates float freely, they would compete down to a zero percent interest on loans in order to capture market share.

¶15. (U) Neither Ambassador Holmer's nor Governor Warsh's delegations had an opportunity to clear this report.
JARRETT